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UNCLAS SECTION 01 OF 04 ROME 002794

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DEPT FOR EUR/WE, EUR/ERA, EB/OMA
TREASURY FOR OASIA - HARLOW, JONES
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STATE PASS FEDERAL RESERVE BANK
FRANKFURT FOR WALLAR

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SUBJECT: BERLUSCONI'S FIRST YEAR ECONOMIC SCORECARD

REF: A. ROME 02198
B. ROME 01744
C. 2001 ROME 06227

¶1. (U) SUMMARY. TWELVE MONTHS AGO, PRIME MINISTER BERLUSCONI TOOK OFFICE WITH A PROMISE TO JUMPSTART THE FALTERING ITALIAN ECONOMY. A MUCH-HERALDED 100-DAY ECONOMIC PLAN WAS DESIGNED AS AN INITIAL STIMULUS, TO BE FOLLOWED BY MORE FUNDAMENTAL ECONOMIC REFORMS. AFTER A YEAR IN OFFICE, THE PRIME MINISTER AND HIS ECONOMIC TEAM ARE STILL SEEKING TO IMPLEMENT WAYS TO RESTORE HEALTH TO ITALY'S AILING ECONOMY.

¶2. (SBU) THE PROLONGED GLOBAL ECONOMIC DOWNTURN, DOMESTIC POLITICS AND SEPTEMBER 11 HAVE SLOWED PROGRESS. OPPOSITION FROM TRADE UNIONS, WHICH HAVE PLAYED A KEY ROLE IN SOCIAL AND ECONOMIC POLICY MAKING, HAS STALLED PROGRESS ON KEY LABOR AND ECONOMIC REFORMS. SOME UNIONS INTERPRET RECENT GOVERNMENT ACTIONS AS AN EFFORT BY IT TO ASSUME A DOMINANT POLICY MAKING ROLE. ALTHOUGH HE ENJOYS A SECURE MAJORITY IN PARLIAMENT, PM BERLUSCONI SEEKS TO BUILD CONSENSUS RATHER THAN IMPOSE MAJOR CHANGES. SINCE THIS PROCESS WILL TAKE TIME, THE PROSPECT FOR SIGNIFICANT ECONOMIC REFORMS IS NOT ROZY. THAT, COMBINED WITH THE ECONOMIC TEAM'S INABILITY SO FAR TO FIND THE RIGHT FISCAL FIXES, MEANS THAT THE PROGNOSIS REMAINS UNINSPIRING,
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FOR THE NEXT YEAR OR SO, FOR THE ITALIAN ECONOMY. END
SUMMARY.

ECONOMIC SNAPSHOT

¶3. (U) ITALY'S STAGNANT PERFORMANCE IN 2001 HAS CONTINUED IN 2002. DURING THE FIRST FOUR MONTHS OF THIS YEAR, ITALY'S BUDGET DEFICIT BALLOONED TO 41.4 BILLION EUROS, UP FROM 38.7 BILLION EUROS IN THE SAME PERIOD LAST YEAR. CONSUMER CONFIDENCE IS DOWN. THE GOVERNMENT HAS TWO ECONOMIC FORECASTS: AN "OPTIMISTIC" FIGURE HAS GROWTH AT 2.3 PERCENT; THE "PESSIMISTIC" ONE AT 1.2 PERCENT. THE CONSENSUS FORECAST IS THAT GROWTH IN 2002 WILL BE 1.3 PERCENT. FINANCE MINISTER TREMONTI INSISTS THAT THERE WOULD BE NO MID-YEAR CORRECTIVE BUDGET EVEN IF THE LOWER PREDICTION HOLDS. ITALY'S ANEMIC GROWTH IS A RESULT NOT ONLY OF THE GLOBAL ECONOMIC SLOWDOWN BUT ALSO OF THE GOI'S DELAY IN CUTTING SPENDING AND ENACTING KEY REFORMS.

BERLUSCONI'S 100-DAY PLAN: SUCCESSES AND SETBACKS

¶4. (U) THE CENTER-RIGHT GOVERNMENT CAME INTO OFFICE IN JUNE 2001 WITH A 100-DAY ECONOMIC PACKAGE DESIGNED TO TURN ITALY'S ECONOMY AROUND. KEY ELEMENTS OF THIS PLAN INCLUDED: A "NEW TREMONTI LAW" (BASED ON ONE FROM THE 1994 BERLUSCONI GOVERNMENT) PROVIDING TAX EXEMPTIONS FOR REINVESTED PROFITS AND NEW HIRING; THE ABOLITION OF INHERITANCE TAXES; NEW AND MORE FLEXIBLE LABOR CONTRACTS; TAX FORGIVENESS FOR REPATRIATION OF CAPITAL, AND INCENTIVES FOR COMPANIES IN THE
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UNDERGROUND ECONOMY TO BECOME LEGAL, TAX-PAYING ENTITIES.

¶5. (U) IN THE FIRST SIX MONTHS OF THE BERLUSCONI GOVERNMENT, THE PARLIAMENT PASSED THE TREMONTI LAW AND APPROVED THE ABOLITION OF INHERITANCE TAXES (WHICH ALREADY WERE BEING PHASED OUT UNDER PREVIOUS GOVERNMENTS). THE GOI EXPECTED THE TREMONTI LAW, BASED ON 1994 RESULTS, WOULD ADD ONE-HALF TO ONE PERCENT OF GDP GROWTH IN A 12-MONTH PERIOD. EVEN UNDER THE BEST SCENARIO, WE BELIEVED THIS PREDICTION WAS OPTIMISTIC. THE TREMONTI LAW HAS HAD LITTLE IMMEDIATE EFFECT, SINCE MOST ITALIAN COMPANIES, IN LIGHT OF THE CONTINUED ECONOMIC DOWNTURN, HAVE POSTPONED INVESTMENTS.

¶6. (U) IN CONTRAST, THE TAX AMNESTY FOR CAPITAL ILLEGALLY EXPATRIATED HAS BEEN A SUCCESS. THE GOVERNMENT OFFERED AN

AMNESTY FOR OFFSHORE, ILLEGALLY EXPORTED CAPITAL WITH A ONE-TIME TAX PAYMENT OF 2.5 PERCENT. WHEN THE PROGRAM ENDED IN MID-MAY, MORE THAN 40 BILLION EUROS HAD REPORTEDLY FLOWED BACK INTO ITALY. THE GOVERNMENT ESTIMATES 360-400 BILLION EUROS HAVE BEEN MOVED TO OFFSHORE ACCOUNTS SINCE THE END OF WORLD WAR TWO. THE AMNESTY HAS BEEN A BOON TO ITALIAN BANKS BUT ALSO WILL LIKELY LEAD TO HIGHER INVESTMENT IN ITALY'S SMALL AND MEDIUM-SIZED BUSINESSES, THE BACKBONE OF THE ITALIAN ECONOMY. LONGER-TERM BENEFITS ARE HARDER TO PREDICT. FINANCE MINISTER TREMONTI, THE ARCHITECT OF THE PLAN, CLAIMS

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FM AMEMBASSY ROME
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INFO EU MEMBER STATES COLLECTIVE PRIORITY
AMCONSUL FLORENCE PRIORITY
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AMCONSUL MILAN PRIORITY
AMCONSUL NAPLES PRIORITY
DEPT OF TREASURY WASHDC PRIORITY
USEU BRUSSELS PRIORITY 2699
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THE TAX AMNESTY WILL INCREASE THE TAX BASE AND HELP REDUCE TAX EVASION. CRITICS SAY THAT THIS ONE-TIME MEASURE WILL NOT DIMINISH THE PROPENSITY TO DODGE TAXES.

17. (U) COMMENT: ALTHOUGH THESE MEASURES WERE DESIGNED TO GIVE A SHOT IN THE ARM TO ITALY'S ECONOMY, WE BELIEVE MORE SIGNIFICANT REFORMS ARE NECESSARY FOR LONG-TERM ECONOMIC VITALITY.

WHAT IS REALLY NEEDED

18. (U) TAX REFORM: ONE OF THE TOP PRIORITIES OF THE BERLUSCONI GOVERNMENT IS TO REDUCE TAXES. CHANGES WILL INCLUDE A REDUCTION OF PERSONAL INCOME TAX RATE BRACKETS, FROM FIVE TO TWO (23 PERCENT UP TO 100,000 EUROS OF TAXABLE INCOME AND 33 PERCENT ABOVE THAT LEVEL); AND REFORM OF CORPORATE TAXES, WITH A DECREASE FROM A 36 PERCENT TO 33 PERCENT TAX RATE. WHILE THE CHAMBER OF DEPUTIES ALREADY HAS APPROVED THESE CHANGES, THE SENATE HAS NOT YET DISCUSSED THEM. EVEN IF THE SENATE MOVES BEFORE THE SUMMER RECESS, THE REFORMS WILL LIKELY ONLY BE APPROVED IN LATE 2002. THE GOVERNMENT WOULD THEN HAVE A TWO-YEAR DEADLINE TO PRESENT ALL THE DETAILS OF THESE REFORMS. AT BEST, THEREFORE, THE UNCLASSIFIED

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POSITIVE EFFECTS OF TAX REFORM WILL NOT OCCUR EARLIER THAN 12004. IN ADDITION, THE NEED TO FINANCE A HIGHER THAN EXPECTED PUBLIC SECTOR DEFICIT -- SOME CAUSES OF WHICH WERE AN UNEXPECTED INHERITANCE FROM THE PREVIOUS GOVERNMENT -- MAY ALSO PUSH BACK THE TIMETABLE FOR TAX CUTS. COMMENT: TREMONTI AND BERLUSCONI BELIEVE THAT LOWER TAXES, MORE EQUITABLY APPLIED, WILL PRODUCE A GREATER INCOME STREAM. TO DO THAT, THEY HAVE TO CAPTURE MORE OF THE UNDERGROUND ECONOMY.

19. (U) INCORPORATING THE UNDERGROUND ECONOMY: ACCORDING TO THE IMF, ITALY'S UNDERGROUND ECONOMY IS EQUAL TO ABOUT 27 PERCENT OF GDP. EMPLOYEES WHO WORK OFF THE BOOKS ACCOUNT FOR

30-48 PERCENT OF THE ENTIRE WORKFORCE. THE GOVERNMENT HAS PROPOSED THREE YEARS OF TAX BREAKS FOR EMPLOYERS WHO BECOME LEGAL ENTITIES; SIMILAR INCENTIVES ARE OFFERED TO EMPLOYEES. THE TAX BREAKS, APPROVED AS PART OF THE 100-DAY PACKAGE, EXPIRE NOVEMBER 30. THE PACKAGE HAS HAD LIMITED SUCCESS. AS OF LATE MAY, ONLY 159 EMPLOYERS AND 500 WORKERS HAVE REPORTEDLY COME FORWARD. COMMENT: WITHOUT CAPTURING MORE OF THIS ECONOMY, IT IS LIKELY THAT TAX REFORM WILL GENERATE LESS REVENUE. END COMMENT.

¶10. (U) PRIVATIZATION: THE BERLUSCONI GOVERNMENT ALSO HAS PROPOSED THE THE SALE OF STATE-OWNED ENTITIES OR GOVERNMENT-OWNED SHARES OF MAJOR COMPANIES, INCLUDING THE ENERGY COMPANY ENEL AND ENTE TABACCI ITALIANI (ITALY'S NATIONAL TOBACCO COMPANY). KEY CABINET OFFICIALS CONTINUE TO REITERATE THIS COMMITMENT TO PRIVATIZATION. UNCERTAIN MARKET CONDITIONS HAVE, HOWEVER, RAISED QUESTIONS ABOUT BOTH THE TIMING AND THE PRICE. COMMENT: PRIVATIZATION IS CRITICAL TO BRINGING DOWN THE PUBLIC DEFICIT. IN ADDITION, THE EU
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COMMISSION'S RECENT RULING AGAINST GOVERNMENT OWNED "GOLDEN SHARES" COULD COMPEL THE GOI TO SELL ITS REMAINING STAKES IN TELECOM ITALIA. END COMMENT.

¶11. (U) PENSION REFORM: ANOTHER CRITICAL STEP FOR LONG-TERM RECOVERY IS PENSION REFORM. ITALY SPENDS NEARLY 15 PERCENT OF ITS GDP ON PENSIONS, ONE OF THE HIGHEST RATES IN THE WORLD, AND, WITH THE LOWEST BIRTHRATE IN EUROPE, FACES THE PROSPECT OF A STAGNANT OR DECLINING ACTIVE WORK FORCE. BY LAW, THE BERLUSCONI IS REQUIRED TO REVIEW THE EFFECTIVENESS OF THE 1995 PENSION REFORM. THE GOVERNMENT HAS PROPOSED MODEST REFORMS, WITH TWO KEY ASPECTS: INCREASE IN AVERAGE RETIREMENT AGE AND INCREASED USE OF PRIVATE PENSION FUNDS. THE GOVERNMENT HAS PROPOSED INCENTIVES, INCLUDING REDUCED CONTRIBUTION RATES, THAT WOULD ENCOURAGE EMPLOYEES TO WORK BEYOND THE CURRENT RETIREMENT AGES OF 60 AND 65, RESPECTIVELY, FOR WOMEN AND MEN.

¶12. (SBU) FEARING THE IMPACT ON THE SOCIAL SECURITY SYSTEM'S VIABILITY, UNIONS OBJECT TO LOWERING EMPLOYER CONTRIBUTIONS. THE GOVERNMENT HAS INDICATED THAT IT WILL TRY TO ADDRESS UNION CONCERNs. DEBATE IN THE TWO CHAMBERS HAS BEEN POSTPONED WHILE THE GOVERNMENT SEARCHES FOR AN AGREEMENT WITH THE UNIONS. EVEN IF UNIONS AND THE GOVERNMENT AGREE, PENSION REFORM WILL BE PURSUED BUT CAUTIOUSLY, DELAYING ANY POSITIVE

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	NSAE-00	NSCE-00	OMB-01	OPIC-01	PA-00	PM-00	PRS-00
	ACE-00	P-00	SCT-00	SP-00	SSO-00	STR-00	TEST-00
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AMCONSUL FRANKFURT PRIORITY
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IMPACT ON THE ECONOMY FOR SEVERAL YEARS. INDEPENDENTLY, RECENT STOCK MARKET BEHAVIOUR HAS ERODED PUBLIC CONFIDENCE IN

LABOR LAW REFORM

¶13. (U) REFORM PROPOSALS ATTRACTING THE GREATEST PUBLIC ATTENTION AND DEBATE INVOLVE LABOR, WITH THE MOST CONTENTIOUS ISSUE BEING ARTICLE 18 OF THE 1970 WORKERS' STATUTE. THIS PROVISION ALLOWS EMPLOYEES FIRED "WITHOUT JUST CAUSE" (AS DETERMINED BY A MAGISTRATE) TO BE REINSTATED IN THEIR JOBS, AS OPPOSED TO RECEIVING ONLY MONETARY COMPENSATION. THE EMPLOYERS' ASSOCIATION "CONFINDUSTRIA" AND THE GOVERNMENT CONTEND THAT ARTICLE 18 DISCOURSES COMPANIES FROM FIRING WORKERS AND, THUS, DISSUADES THEM FROM HIRING NEW EMPLOYEES. TO ENCOURAGE JOB CREATION, THE GOVERNMENT PROPOSES THAT, UNDER CERTAIN CONDITIONS, THE RIGHT TO REINSTATEMENT BE WITHDRAWN FOR A TRIAL PERIOD. (ARTICLE 18 APPLIES ONLY TO FIRMS WITH MORE THAN 15 WORKERS. EMPLOYEES OF FIRMS WITH FEWER THAN 15 ON THEIR PAYROLL CAN ONLY ASK FOR COMPENSATION, NOT REINSTATEMENT.)

¶14. (SBU) THE UNIONS SEE ARTICLE 18 AS A PROFOUND SYMBOL, A UNCLASSIFIED

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"BILL OF RIGHTS" FOR WORKERS, REPRESENTING A SUCCESSFUL FIGHT FOR DIGNITY AND LEGAL PROTECTION. AS SUCH, IT HAS BECOME A RALLYING POINT FOR TRADE UNIONS AND A WAY FOR THEM TO UNITE OTHERWISE FRAGMENTED LEFTIST GROUPS. THE GOVERNMENT'S PROPOSAL TO ALTER ARTICLE 18 ALSO HAS OTHER ASPECTS. TRADE UNIONISTS BELIEVE THAT THE GOVERNMENT, PROMPTED BY EMPLOYER ASSOCIATIONS, IS TRYING TO CHANGE THE "RULES OF THE GAME" UNILATERALLY. SINCE THE EARLY 1990S, THE THREE SOCIAL PARTNERS -- GOVERNMENT, EMPLOYERS, AND UNIONS -- HAVE ENGAGED IN A PROCESS OF "CONCERTAZIONE" -- ROUGHLY TRANSLATED AS "CONSULTATION" -- TO HAMMER OUT SOCIAL AND ECONOMIC POLICY THROUGH CONSENSUS. THIS WAS BELIEVED TO BE ESSENTIAL TO STABILITY DURING A TIME WHEN RULING COALITIONS WERE WEAK. TO TRADE UNIONISTS, THE GOVERNMENT'S ACTION ON ARTICLE 18 IS AN ATTEMPT BY IT AND EMPLOYERS TO TILT THE BALANCE OF POWER IN THEIR FAVOR. (COMMENT: THE UNIONS' FEAR THAT THE GOVERNMENT AND EMPLOYERS ARE TRYING TO SHIFT THE BALANCE IS NOT FAR OFF THE MARK. THE EMERGENCE AFTER THE MAY 2001 ELECTIONS OF A SIZABLE AND CENTER-RIGHT MAJORITY HAS MEANT THAT UNIONS' PARTICIPATION IN ECONOMIC POLICY-MAKING IS NO LONGER REQUIRED. END COMMENT) RESPONDING TO THIS PERCEIVED THREAT, CGIL, JOINED BY UNIONS CISL AND UIL, SUCCESSFULLY ORGANIZED THE LARGEST ONE-DAY GENERAL STRIKE IN RECENT ITALIAN HISTORY ON APRIL 16TH.

¶15. (SBU) DESPITE THE STRIKE'S SUCCESS, THE BERLUSCONI GOVERNMENT EMERGED LARGELY UNSCATCHED. OPINION POLLS STILL GIVE OVERWHELMING MAJORITY SUPPORT TO THE CENTER-RIGHT GOVERNMENT. RECENT LOCAL ELECTIONS (WITH NONE OF ITALY'S MAJOR CITIES OR MORE SIGNIFICANT PROVINCES INVOLVED) SAW NO LOSS IN CENTER-RIGHT POWER. THE BERLUSCONI GOVERNMENT
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MAINTAINS THAT IT STILL INTENDS TO CONSULT WITH UNIONS OVER ARTICLE 18.

¶16. (SBU) INDEED, THE GOVERNMENT IS NOT RUSHING TO ENACT ITS PROPOSED CHANGES TO ARTICLE 18 AND RECENTLY DROPPED THE MEASURE OUT OF AN OMNIBUS LABOR REFORM BILL, WHILE "POSTPONING" ARTICLE 18 CHANGES TO AN UNDEFINED FUTURE OCCASION. LABOR MINISTER MARONI HAS CALLED FOR A NEW SOCIAL PACT ON LABOR AND WELFARE, AND OFFERED A SEAT AT THE TABLE TO ALL UNIONS, WITH A SPECIAL APPEAL TO CGIL. CISL AND UIL ACCEPTED THE GOVERNMENT'S OFFER; CGIL DID NOT AND HAS CALLED FOR NEW ROUND OF REGIONAL STRIKES.

¶17. (SBU) HOW THIS CONFRONTATION WILL ULTIMATELY PLAY OUT IS STILL UNCERTAIN. UNLIKE 1994, BERLUSCONI DOES NOT FEAR THAT HIS COALITION WILL BREAK APART BECAUSE OF UNION OPPOSITION. INDEED, THE NORTHERN LEAGUE, THE WITHDRAWAL OF WHICH FROM THE GOVERNING COALITION WAS RESPONSIBLE FOR THE DEMISE OF THE PREVIOUS BERLUSCONI GOVERNMENT, IS SPEARHEADING THE CHARGE FOR SUCH REFORM. LABOR MINISTER MARONI, A NORTHERN LEAGUE PARTY MEMBER, IS THE ARCHITECT OF THE LABOR REFORMS. MAJORITY POPULAR SUPPORT FOR THE BERLUSCONI GOVERNMENT ALSO STRENGTHENS ITS POSITION.

¶19. (SBU) WHATEVER THE OUTCOME -- AN OUTRIGHT WIN FOR THE GOVERNMENT, A WATERED-DOWN COMPROMISE VERSION OF ARTICLE 18

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NSAE-00 NSCE-00 OMB-01 OPIC-01 PA-00 PM-00 PRS-00
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P 101722Z JUN 02
FM AMEMBASSY ROME
TO SECSTATE WASHDC PRIORITY 4144
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AMCONSUL FLORENCE PRIORITY
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REFORM (THE TWO OPTIONS MOST LIKELY), OR A RETREAT BY THE GOVERNMENT (LEAST LIKELY) -- ONE THING IS CERTAIN: SIGNIFICANT LABOR REFORM IS YEARS AWAY. ARTICLE 18 REFORM IS PERIPHERAL TO REFORMS THAT ARE TRULY NEEDED.

COMMENT

120. (SBU) THE BERLUSCONI GOVERNMENT HAS YET TO FACE STRONG CRITICISM FOR FAILURE TO REVERSE ITALY'S ECONOMIC SLOWDOWN. THE EVENTS OF SEPTEMBER 11 AND THE GLOBAL ECONOMIC WOES CONTINUE TO BUY THE GOVERNMENT TIME. IN ADDITION, THE PUBLIC AND POLITICAL OBSERVERS SEEM TO UNDERSTAND THAT THE GOVERNMENT IS SERIOUS ABOUT ECONOMIC REFORM. ITS EXPRESSED DESIRE TO CONSULT WITH UNIONS ALSO HAS BOUGHT THE GOVERNMENT PUBLIC GOOD WILL.

121. (SBU) CRITICISM IS, HOWEVER, HEATING UP. THE EUROPEAN COMMISSION HAS CRITICIZED ITALY FOR ITS BALLOONING BUDGET DEFICIT. CENTRAL BANK GOVERNOR FAZIO, IN HIS ANNUAL ADDRESS ON MAY 30, RAISED CONCERN ABOUT THE INSUSTAINABILITY OF THE PUBLIC DEFICIT. THE GOVERNMENT CAN NOT DELAY MUCH LONGER ON BOTH SHORT-TERM AND LONG-TERM MEASURES TO CUT SPENDING, REIN IN THE DEFICIT, AND STIMULATE GROWTH. THE NEXT MONTHS ARE UNCLASSIFIED

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CRITICAL. IF THE BELUSCONI GOVERNMENT DOES NOT SOON IMPLEMENT THE RIGHT MIX OF FISCAL FIXES AND BEGIN TO ENACT SIGNIFICANT REFORMS, THE ROAD TO A STRONG ECONOMIC RECOVERY WILL BECOME EVEN LONGER AND HARDER. MOREOVER, THE EFFECTS OF ANY SUCCESSFUL REFORM WILL NOT BE FELT BEFORE THE NEXT NATIONAL ELECTION IN 2005.

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